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SUBJECT: GOP DECENTRALIZATION "SHOCK" A NECESSARY BUT  
INCOMPLETE STEP FORWARD

REF: A. LIMA 4451

- 1B. 05 LIMA 4661
- 1C. 05 LIMA 4634
- 1D. 05 LIMA 4633
- 1E. 05 LIMA 4217

Sensitive But Unclassified. Please handle accordingly.

Summary:

11. (SBU) President Garcia has announced a series of measures to accelerate the GOP's decentralization process, including the transfer of many government functions and over \$1 billion USD to the regions and municipalities in 2007. The political motive behind the initiative is clear -- Garcia will be transferring substantial blame for poor services to mostly-opposition controlled regions and municipalities. Many local governments are unprepared to assume the new duties. For all that, the Garcia proposal has some strong merits. The Toledo government's effort to build professional capacity before transferring authorities moved too slow. Moreover, moving resources and decision-making closer to the people is a rational way to address the dangerous feelings of exclusion that this year's elections made so evident in Peru's highlands. One controversial proposal in the package would cede parts of the GOP's control of the licit coca market to the Cuzco regional government. End Summary.

Garcia's decentralization "shock"

12. (U) President Garcia has declared that decentralization, or the transfer of government responsibility and resources from the national to the regional and municipal governments, is his most important state reform. On 10/18 Garcia announced 20 measures to advance the GOP's decentralization process and moved up the deadline by three years for the central government to transfer certain financial and operational responsibilities to regional and local authorities. (Ref C, D). In total, the package would shift 185 government functions, including some social programs and 3.5 billion soles (over \$1 Billion USD) to regional and municipal governments by the end of 2007. Significant elements in Garcia's package include:

-- Through pilot projects, the national government will transfer primary health care and primary educational responsibilities to the municipalities;

-- Regional governments will select and manage regional program directors, who currently report to the central government ministries;

-- The regional government of Cuzco will assume the functions of the National Coca Company (ENACO) (see para 7);

-- The national government will transfer road projects, financed by World Bank and International Development Bank credits, to the regions;

-- The regions will manage electricity distribution;

-- The Transportation and Communications Ministry will connect over 4000 communities to the internet in the next year;

-- The government will offer tax incentives for municipal infrastructure projects and industry in the Andean highlands;

-- The government will relaunch the process to form "megaregions" that stalled in October 2005 after failed referenda (ref B); and,

-- The government will provide training for local and regional governments as they assume more responsibilities.

All that glitters...?

¶3. (SBU) The head of USAID's Pro Decentralization Program (PRODES) told Poloff the proposals are a necessary step forward and the political will appears real, but he identified three concerns: 1) legal structures are lacking

(i.e., an Organic Law for the Executive Branch, a Public Service Employment Law), 2) the would-be regional and local implementers need training and preparation to be able to successfully take over the responsibilities, and 3) the GOP's National Decentralization Council (CND) that will coordinate and facilitate the transition lacks the technical capabilities to do so.

¶4. (SBU) USAID program experts highlighted three additional areas that need attention for the decentralization effort to be successful. First, to date the GOP has made little progress on setting national standards for the delivery of services that now will be responsibility of regional and local government, raising the prospect of discrepancies in the quality of services provided by the regions. Second, the national government agencies have a limited capacity to monitor local performance. Third, decentralization raises complex financial management and accountability issues regarding the transparent transfer of resources from the central to the regional and local levels. While the GOP has taken steps with a system to track general movements of resources, additional monitoring and oversight are necessary.

¶5. (SBU) Some commentators have criticized the proposals as a collection of cherry-picked announced measures with political motivations. The former head of the GOP's National Decentralization Council (CND), Luis Thais, in an "El Comercio" editorial said the measures were disjointed and lacked a focused vision and an integrated national strategy. Others speculated that the announcement was timed to benefit APRA in advance of the November regional and municipal elections. The current head of the CND, who will oversee the transition, fed this skepticism when he told press after Garcia's announcement that he was unfamiliar with over a third of the measures. Analysts in Arequipa told PolCouns that the regional and municipal governments doubt the central government's commitment and intentions, and will wait for tangible changes before they believe.

¶6. (SBU) CND Technical Secretary Wilfredo Silva defended the GOP plan, but acknowledged that the schedule for transferring responsibility is ambitious and a major roadblock is the

local and regional capacity to assume these new roles. He blamed the skepticism surrounding decentralization on the prior government's lack of commitment, which was exacerbated following its decisive loss in the 2002 regional elections.

ENACO to Cuzco - A Danger of Increased Coca Cultivation?

¶ 17. (U) One of the more controversial proposals is the transfer the National Coca Company (ENACO), which oversees management of the licit coca market, to the Cuzco regional government (Septel). (Note: ENACO is the state-owned company responsible for buying and selling licit coca. According to law, only the GOP through ENACO can commercialize coca. End Note.) The GOP sent implementing legislation, which is still under consideration, to Congress for this transfer. The draft law proposed that the national government retain two of the five seats on ENACO's governing board. According to GOP proponents, this would allow the national government to ensure that ENACO maintains the licit coca control and marketing functions at a national level and that Peru complies with international treaty commitments.

¶ 18. (SBU) Comment: Although 70 percent of Cuzco coca goes to narcotrafficking, Cuzco has the highest concentration of traditional coca users and the most suppliers of licit coca. Both we and the GOP are interested in driving a wedge between traditional licit producers and coca farmers who supply narcotraffickers. Cuzco Regional President Carlos Cuaresma last year tried to strengthen his political hand with a regional ordinance, eventually overturned, that declared all coca in Cuzco legal (Ref E). The challenge with the ENACO proposal will be to give Cuzco the appropriate traditional use status without letting regional politicians use it as a banner to "legitimate" newer coca that goes to narcotraffickers; the latter would only stimulate increased coca production. End Comment.

Comment:

¶ 19. (SBU) A massive shift in government authority is complicated in Peru because the country has always been highly centralized and has few domestic models to learn from. Moreover, President Garcia's decentralization proposals are freighted with controversial political motives. Garcia knew even before the November 19 regional elections that his party would take a pasting in them; his rapid transfer downward of funds and responsibilities will make it harder for opposition-led regional governments and municipalities to blame the central government for poor services and infrastructure.

¶ 10. (SBU) A fundamental challenge in Peru is the lack of citizen confidence in democratic institutions. Pushing down responsibility for essential services to unprepared local and regional Governments without adequate preparation may exacerbate this problem. At the same time, the profound feelings of exclusion that were so visible during the spring 2006 national elections (and which fed Ollanta Humala's radical candidacy) are best addressed by putting more decisions and resources close to communities, particularly in the highlands.

¶ 11. (SBU) Given this mixed picture, the Garcia government's plan may be among the best choices in a menu of bad options. The Toledo administration's approach, which emphasized building capacity before transferring authority, moved so slowly that it was hard to see when the process would come to fruition. Many local governments were in no hurry to assume more responsibility -- and blame -- for providing services. While Toledo can be justly faulted for giving only intermittent attention to decentralization, it is equally true that many regional/local governments appeared to give low priority to building the capacity to take on more functions. There is justification for thinking that they need to be stressed by having a quicker-paced process thrust upon them. Many unprepared governments will fail the test they are about to undergo. It remains unclear whether and

how the national government will address such failures.

¶12. (U) The Embassy, through USAID, has provided technical assistance to the key agencies and has trained nearly one-third of the country's municipalities and regional governments, but the need for additional capacity building is large. We will remain engaged in supporting and consolidating the decentralization process as an important component of our efforts to promote good governance. End Comment.

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